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July 8, 1994

HAND DELIVER

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, NW #222
Washington, DC 20554

Re: ET Docket No. 93-266
Ex Parte Presentation

Dear Mr. Caton:

Pursuant to Section 1.1206 of the Commission's rules, this letter is to advise you that Douglas G. Smith of Omnipoint Communications, Inc. and I met yesterday with David Solomon, John Ingle, and Christopher Wright of the Commission's General Counsel's Office. Also participating in the meeting were Alexander Netchvolodoff of Cox Enterprises, Inc., Werner Hartenberger of Dow, Lohnes and Albertson (representing Cox Enterprises, Inc.), and Jonathan Blake of Covington & Burling (representing American Personal Communications). At the meeting, we discussed matters related to the above-referenced docket, as stated in Omnipoint's prior written comments and reply comments in that docket. We also discussed issues contained in the attached June 22, 1994 letter from Omnipoint to Commissioner Susan Ness and the attached July 5, 1994 letter from Omnipoint to you. Lastly, we discussed issues related solely to the above-referenced docket raised in the attached June 29, 1994 letter from Montgomery Securities to Commissioner Quello.

In accordance with the Commission's rules, I hereby submit one original and one copy of this letter and its attachments.

Sincerely,

Ronald L. Plesser
Counsel for Omnipoint
Communications, Inc.

Enclosures

cc: David Solomon
John Ingle
Christopher Wright

Omnipoint
CORPORATION

June 22, 1994

Honorable Susan Ness
Federal Communications Commission
1919 M Street, N.W.
Room 832
Washington, D.C. 20554

Re: Pioneer's Preference Program
ET Docket No. 93-266
Ex Parte Presentation

Dear Commissioner Ness:

The future of the pioneer's preference program and the existing pioneers given the new competitive bidding authority was the subject of last October's NPRM in ET Docket No. 93-266. As such, this is a non-restricted proceeding. We are writing this letter to outline some of the key issues, especially in light of the recent speech by Vice President Al Gore. We were pleased to see that the Administration supports the pioneer's preference program, but we have deep concerns over the use of "discounts" as an incentive for inspiring small entrepreneurs to take the risks or attract the capital necessary to achieve new innovations. We strongly urge that any payment mechanisms for at least small business pioneers be related to the success of the pioneer's business, and not to the price some other business is willing to pay for RF spectrum. Several payment mechanisms could possibly achieve this, as noted below.

Before addressing the multiple problems with discounts and the advantages of other payment methods, it is important to show the fallacy of *some* of the arguments for charging pioneers. Some parties have argued that pioneers should be charged because the advent of auctions changed the "competitive dynamics," whereas under lotteries everyone received their license for free. Several parties have complained that moving from lotteries to auctions gives the pioneers a competitive cost advantage that didn't exist before. This is completely false.

Absolutely nothing changed with respect to the issue of how much non-pioneers would pay for their licenses simply because the licensing mechanism changed from lotteries to auctions. Before auctions, every company which seriously wanted a license knew it would have to buy the licenses from the lottery winners. Indeed, lotteries were criticized as "private auctions." Dozens

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if not hundreds of licenses awarded by lottery were purchased by the giant cellular companies from the lottery winners. Those giant cellular companies are being disingenuous when they now argue that if lotteries had been used for PCS that they would have received their PCS licenses for free. The probability that any party would win a lottery license of their choice in an area where a pioneer's preference license had been awarded is infinitesimally small. 60,000 lottery applications were received in just two days in the 220MHz docket for 5 Kilohertz channels. Imagine how many applications would have been submitted for 30MHz channels.

Thus, this "new competitive unfairness" issue is a complete illusion. If lotteries had been kept, would the FCC be considering charging the pioneers 80% of what the lottery winners sold their licenses for to the RBOCs? Obviously not.

A second false argument is the assertion that the cost advantages to a pioneer for receiving a "free" license will make the non-pioneers businesses economically unviable. One RBOC called this advantage "insuperable." These parties are implying that the price they have to pay in an auction renders their businesses uncompetitive. But, no one is charging these non-pioneers for their licenses, they are bidding on them. The government is not setting a price on their license, as bidders they set the price. Whatever price is set by the market will take into account the pioneers situation, as well as the fact that there are cellular licensees already in that market which received their license for free and have a 10 year head start.

A third fallacy is that pioneers receive their licenses for free. The truth is that the pioneer's process requires pioneers to invest their capital at the time it is riskiest without any guarantee of obtaining an allocation for their ideas, let alone a license. Those bidding in an auction are bidding ***riskless*** dollars. Either they win the license or they do not spend any money.

The fourth fallacy is that the pioneer's program takes money away from the government.. The truth is that the program will increase total revenue to the Treasury. Clearly, the pioneer's preference program brought numerous serious parties into the process of solving the problems facing PCS four years ago. Whatever price the total PCS spectrum is auctioned for today it will be more because of the pioneer's preference program. Perhaps more importantly, the licensing process was expedited by many years. Cellular licensing took 14 years with only 3 parties conducting experiments. PCS took 3 1/2 years with over 50 would be pioneers conducting experiments.

Nonetheless, going forward there is a strong desire on the part of many to charge pioneers something for the spectrum. The problem is that "discounts" don't really work in the context of a pioneers preference program. Discounts end up setting the pioneer's payment based on how

other parties value the spectrum, even if those other parties have infrastructure advantages which far exceed the value of a "discount." to a pioneer. We believe royalties or a similar scheme are the only mechanisms which tie the pioneer's payments to the actual business of the pioneer rather than the business of some other company. The traditional objections against royalties can be overcome in the pioneer's preference program, especially for small businesses. First, the primary objection to the use of royalties in an auction is because there is no way to compare two royalty bids, let alone a royalty bid versus an upfront cash bid. But there are no bid problems with applying a royalty to a dispositive license award to a pioneer. Second, the number of pioneers will always be very small and thus be manageable. Third, conditions can be specified at the time of the application if royalties are to be used which prevent ambiguities and gaming. Fourth, especially with small businesses, the royalty can be set on ***all*** revenue of the entity receiving the preference in order for it to be eligible to use a royalty mechanism.

In establishing and reconsidering the pioneer's preference program, the Commission considered granting "comparative" or "weighted" preferences and rejected this. Specifically, the FCC ruled:

"A weighted preference would provide no assurance to the innovative party that it would, in fact, receive a license. As we stated in the Report an Order, any approach that would permit an innovator to be foreclosed from a license by another party would undermine the value of the preference and thereby fail to accomplish its public interest purpose. Consequently, we affirm that the preference will be dispositive." Report and Order, 6 FCC Rcd. 3488, 3495 (1991).

A discount does not guarantee a license to a pioneer. Certainly, a bidding discount doesn't even come close to assuring a license. Even a dispositive award of a license to a pioneer, with the requirement to pay X% of what some other party pays, will result in many small business pioneers failing to obtain a license because they cannot justify the price. Only a royalty or similar scheme, such as per subscriber fees, which tie payments to the success of the pioneer's business, will fulfill the policy goal of rewarding innovation with the guarantee of a license.

The problems with discounts can be seen with a few examples. Long distance companies have the ability to use RF spectrum to bypass the LEC access charges. With 45% of their ***revenue*** at stake they can afford to pay multiples of what a start-up company could ever justify for a license. The same is true with respect to a company that has other key infrastructure assets, whether it is LEC, a cellular company, a cable TV company, a company with retail distribution, etc. A start-up company doesn't own a long distance business such that it can reap these structural benefits. Even a scheme which provided for installment payments would not address

the fact that a small business could not justify the same total price as another company which can exploit unique assets.

Other implementation problems exist with "discounts". The spectrum bands are not necessarily identical within any given docket and thus there may be no exact comparables. Consider PCS, where different numbers of OFS incumbents occupy each of the PCS bands as well as different numbers of public safety users which have 5 years to move. If auctions are held sequentially and a "comparable band" is auctioned early to set the pioneer's price, what happens if in later auctions the licenses go for much less, or go for free? The pioneer would have been better off without a preference. What happens if the purchaser of a "comparable" license later defaults? What happens if, in two years, the purchaser goes bankrupt or never builds a system because they overpaid? What happens if the "discount" is less than what the pioneer spent to develop the innovation? How is a small business pioneer supposed to raise money before the auctions to finance its innovations when it cannot tell its investors how much the license will cost or whether they could ever justify the price that some other company might pay?

All of these problems can be solve with a royalty or per subscriber fee that ties the pioneer's payments to the pioneer's business.

We will be submitting shortly more detailed proposals for implementing non-discount based payment mechanisms. We urge you to consider the above issues and not lose sight of the purpose of the pioneer's program in changing the rules going forward.

In accordance with the Commission's ex parte rules, two copies of this letter will be submitted this day to the Commission's Secretary.

Sincerely,

Douglas G. Smith
President, Omnipoint Corporation

Enclosures

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Pioneer's Program Summary

- The U.S. Treasury Will Raise More Money with the PCS Auctions Because of the Pioneers Preference Program.
- The Pioneers Preference Program Increased the Value of PCS to the Government Because it Incented Over 200 Experimental License Requests for PCS and Unprecedented Innovation, Compared to Only 5 Experimental Requests in the 15 months Before the Pioneers Program.
- The Pioneers Preference Program Expedited the Rule Making on PCS By Years: PCS Took Less Than 4 years, Cellular Took 14 Years.
- Every Year Which PCS was Expedited Increases Total Future GNP by Billions of Dollars.
- Only 1/10th of 1% of the Licenses were Awarded to the PCS Pioneers.
- Only 3/10th of 1% of the PCS RF Spectrum was Awarded to the PCS Pioneers.
- Only 5% of the "Pops" x RF Spectrum was Awarded to the PCS Pioneers.
- 6 Rounds of Filings and Comments were Held in the Broadband PCS Pioneers Program. Plus Peer Review of Hundreds of Pages of Experimental Reports.
- A special FCC NPRM Was Undertaken to Re-evaluate the Pioneers Program After the Auction Legislation.
- 84% of the 46 Comments on the NPRM Supported the Pioneers Program.
- Only 4 Giant Telecom Companies - Which Received Licenses For Free - Opposed the FCC.
- No Party Sought Reconsideration of the FCC's Final Decision to Treat the PCS Pioneers Under the Original Rules, i.e. Without Payment.
- In Total, Over a Period of Years, Thousands of Pages of Comments and Replies Have Been Submitted Regarding the PCS Pioneers Preference Decision. Congress was Integrally Involved and Kept Up To Date.
- The FCC Unanimously Affirmed and Reaffirmed Their PCS Pioneers Decision Three Times In Light of a Full Record.

Omnipoint CORPORATION

ARGUMENTS FOR CHARGING PIONEERS ARE BASED ON FALSE ASSUMPTIONS

- Auctions did not change any competitive pricing issues of Pioneers vs. Non-Pioneers.

- Non-Pioneers would have bought licenses from lottery winners.
  - 60,000 lottery applications in 2 days for 5 KiloHz licenses at 220 MHz
  - Southwestern Bell, for example, bought 20 cellular licenses awarded by lottery

- There is no "unfair" or "insuperable" competitive disadvantage to Non-Pioneers.
  - Non-Pioneers set the price of their licenses through bidding
  - No one is telling Non-Pioneers how much to pay, thus the market will establish competitive prices for PCS licenses
  - Long distance companies and those with infrastructure assets have far greater "cost advantages" than Pioneers
  - With 2,500 licenses, many may go "free" if no bid

WHY DISCOUNTS WILL NOT WORK FOR PIONEERS IN THE FUTURE

A "Discount" Is Not What Induced The Risks, Investments, and the Disclosure of Proprietary Ideas

The Award Is A "Guarantee to a License ... Not Subject to Competing Applications"

A "Discount" Does Not Guarantee A License To A Pioneer

A "Discount" Does Not Reflect The Differing Value Put On A License For Reasons Other Than Innovation or Even Offering the Pioneer's Service, For Example Long Distance Co.'s Can Use Their Licenses For Bypass

How Does A Small Pioneer Raise Money to Bid Against Giants With A Discount

Installment Payments Still Force the Pioneer to Value the License For Purposes Other Than Its Business

Small Business Pioneer's Would Have No Way to Raise Money Before an Auction Because They Would Have No Idea What the License Would Cost or Whether They Would Actually End Up With a License

POSSIBLE SOLUTIONS

Any Charging Mechanism Should Be Related to the Pioneer's Business and Use of the Spectrum Not to What Others Would Use the Spectrum For

Royalties or Similar Schemes Are Critical In Order To Tie Payments to the Pioneer's Success Rather Than the Speculation of Others

5. We further stated in the *Report and Order* that an initial determination of entitlement to a pioneer's preference would be made at the time a notice of proposed rule making (NPRM) was issued proposing rules for a new service or modifications to rules in an existing service. Finally, we stated that no preference would be awarded in proceedings in which an NPRM addressing a new service or technology had been issued prior to release of the *Report and Order* adopting the pioneer's preference rules.

DISCUSSION AND DECISIONS

Need for More Specific Preference Criteria and Nature of Preference

6. NAB argues that the criteria for a pioneer's preference should be clarified. According to NAB, this will prevent the Commission from being inundated with preference requests and judicial review proceedings initiated by those denied a preference or by competitors to those receiving a preference. NAB also maintains that we should provide specific examples of the kinds of improvements that might warrant a preference. Further, in NAB's view, the preference should at most be comparative rather than a guarantee of a license. NAB asserts that a guarantee of a license would be an excessive benefit and could lead to spectrum requests for unneeded services.

7. *Decision.* As discussed in the *Report and Order*, it is necessary to make the standard for a pioneer's preference as specific as possible to provide guidance to innovators financial institutions as to when a preference might granted. However, the standard must be somewhat flexible in order to be applicable to the various types of proceedings in which it might be used. To enunciate an inflexible standard would narrow the scope of the preference to such an extent that some genuinely innovative proposals would not qualify. Such a standard would undermine our goal in this proceeding of encouraging the development of innovative proposals for new radio services and technologies. While we cannot forecast either number of preference requests or the number of requests for judicial review of our preference decisions, we nonetheless continue to believe that the standard we have established is sufficiently specific without being so inflexible as to undermine its purpose of fostering new spectrum-based technologies and services.

8. With regard to NAB's contention that the preference should be comparative rather than a guarantee of a license, we considered and rejected this argument in the *Report and Order*. A weighted preference would provide no assurance to the innovative party that it would, in fact, receive a license. As we stated in the *Report and Order*, any approach that would permit an innovator to be foreclosed from a license by another party would undermine the value of the preference and thereby fail to accomplish its public interest purpose. Consequently, we affirm that the preference will be dispositive. However, we emphasize that a preference will generally be limited to one geographic area and the preference holder will face competition from other service providers.

Requirement for an Experiment

9. NAB argues that a showing of technical feasibility in lieu of an experiment is insufficient justification for awarding a preference. In NAB's view, requiring only a technical showing could mean that a preference would be based on mere speculation that a service might work and result in technically inferior services, since there would be no mechanism for comparing the technical proposals of applicants competing for a preference. On a related issue, SCI argues that the rules are unclear as to the showing that must be made before the Commission will issue an initial determination that a preference for a particular applicant is warranted. Specifically, SCI argues that the *Report and Order* does not clearly state whether, in situations in which the prospective pioneer also requests experimental authority, a preference will be withheld until those experiments actually have been performed. SCI requests that we clarify this issue by ruling that, while the completion of experiments may be a prerequisite to the final grant of a preference, a conditional preference may be awarded prior to commencement of those experiments.

10. *Decision.* We continue to believe that while performance of an experiment generally will be extremely beneficial, since in most cases a substantially different technology or service will be proposed, it should not be absolutely required as a prerequisite to obtaining a preference. We disagree with NAB that requiring only a technical showing means that a preference could be based on mere speculation that a technology might work and result in technically inferior services. We intend to analyze technical showings as rigorously as the results of experiments to ensure that a preference applicant's proposed new service or technology is viable and worthy of a preference.

11. Regarding SCI's request to clarify our standard, we believe that a preference applicant relying upon an experiment rather than a written technical submission at least must have commenced its experiment and reported to us preliminary results in order to be eligible for award of a conditional preference. If the applicant conducts an experiment to demonstrate the technical feasibility of its proposal, the findings of that experiment will be one of the major components that we will use in determining whether a tentative preference is warranted. If no experimental results are available we would not have the information needed to award a tentative preference. While we recognize that an experimental license applicant may have to wait 90 or more days to have its application approved, there also is a time period between the submission of a preference request and the award of a tentative preference. Therefore, the preference applicant should have ample time to initiate its experiment and obtain at least preliminary results.[2] Accordingly, we find that a tentative preference will not be awarded to an applicant that has not submitted a demonstration of technical feasibility nor commenced an experiment and reported to us at least preliminary results.

[2] Under our revised preference deadline procedure, a preference request must be submitted prior to consideration of the relevant NPRM. *See* paragraph 26, *infra*.

license in the authorized service. We will permit the person receiving a preference to select the one area of licensing that it desires to serve. The area selected will depend on how the Commission report and order defines the area of operation under its rules: *e.g.*, city or region. In cases where the Commission adopts rules defining service areas different than had been proposed or anticipated by the petitioner, we will permit a choice of eventual licensing for the pioneer to be made after a report and order is adopted in the proceeding. In general, we are adopting an approach such that the pioneer's preference would be awarded for the area defined for the service under our licensing rules. For example, if we decide that a service should be licensed on a Metropolitan Statistical Area (MSA) basis, the pioneer's preference, if awarded, would apply to the MSA designated by the innovator.

54. We will generally not grant a nationwide preference or a preference for more than one service area. Our goal is to create an incentive for innovation by establishing a certainty that an otherwise qualified applicant will be able to participate in the proposed service. We must balance this goal against our long-standing desire to encourage diversity in communications services, wherever possible. We believe that granting a pioneer a preference for one area will generally be sufficient incentive to bring its ideas to the Commission. Where a service is inherently nationwide, we will consider granting a nationwide preference. However, we do not believe that granting a preference for more than one service area would usually be necessary to accomplish the purpose of adopting a pioneer's preference.

Multiple Preferences/Deviation of Proposal From Final Service Rules

55. The *Notice* sought comment on whether the Commission should consider granting multiple preferences where more than one party submits a petition to allocate spectrum and request for a pioneer's preference for the same type of service, and the service lends itself to multiple licensees. It further sought comment on the extent to which an innovator's proposal could deviate from the final rules adopted for a service and still qualify for a preference. For example, the Commission might determine to locate the service in a different frequency band than that proposed by the innovator. Similarly, the Commission might allocate less spectrum than requested by the innovator or might modify the service as a result of information developed in the proceeding.

56. Commenting parties express various opinions as to whether multiple preferences should be permitted and how much deviation should be permitted for an innovator to qualify for a preference. Some commenting parties contend that the Commission should award a preference only to the first qualified applicant for a service. To permit otherwise, it is explained, will encourage the filing of competitive applications that will delay the introduction of service. Other parties maintain that, in appropriate circumstances, more than one preference should be awarded. They claim that the possibility of multiple preferences may stimulate diverse technical approaches to a proposed service. Virtually all commenting parties recognize that it is inevitable that a final Commission report and order will differ in some respects from an initiating proposal. They argue that final rules need not precisely track the proposal for a preference to be granted. Indeed, it is noted, often a proposal is refined during the course of a proceeding. Only if the Commission decision is substantially different, it is argued, should the preference be lost. A more liberal view expressed is that it is enough if the applicant has made a valuable contribution for a preference to be awarded.

57. *Decision.* Our objective in this proceeding is to provide incentive to innovators to either bring forth new services or to increase the efficiency of existing services. We are convinced that this objective can best be accomplished by giving otherwise qualified innovative parties an assurance that their efforts to develop a new service or technology will result in a benefit if adopted in some general form by the Commission. We believe that in many services there will be a single, clear-cut innovator, while in other services, it will be difficult to distinguish among several innovative parties. In the latter situations, we find it appropriate to award preferences to each applicant that can meet the eligibility standard for being awarded a preference. For example, if the Commission adopts rules that combine aspects of two or more applicants' proposals or rules that permit the use of two or more applicants' proposed technologies, we believe that more than one preference would be warranted. We recognize that there is a potential drawback to awarding multiple preferences in that some parties who are not truly pioneers may be encouraged to file "copycat" applications in an attempt to gain a preference.[12] However, we will look very carefully at each application to ensure that what is being proposed meets the standard set forth in paragraph 47, *supra*. To the extent that an application is deficient in this respect, no preference will be awarded. Also, in some cases where multiple preference requests are filed, it may better serve the public not to grant any of them.

58. We note that a situation could arise in which the final rules adopted for a service would be so different from all of the service proposals that any preference would be inappropriate. Nevertheless, while we will continue to review our decisions on a case-by-case basis, it will be our general policy to award a preference to any otherwise qualified innovator meeting our standard even if the Commission's final rules for the service are not identical to the innovator's original proposal. However, if the modifications are so significant that the particular innovator does not meet the eligibility standard, we will not award a preference to that innovator. We believe that such an approach should result in providing innovators with the certainty necessary to garner financial support in a timely manner and should ensure that the benefits of the new service can be realized expeditiously by the public.

Timing of Preference Award

59. In the *Notice*, the Commission proposed to set forth its initial determination regarding whether to grant a preference request at the time a notice of proposed rule making (NPRM) on the innovator's proposal is issued. Relatively few commenting parties address this proposal. Some parties support it while others recommend that all action on whether to grant a preference be deferred until the report and order stage of the proceeding.

60. Those arguing in favor of granting a preference when an NPRM is issued point out that early designation is necessary to provide the innovator with continued incentive to pursue its project and raise necessary capital.

Omnipoint CORPORATION

COMMENTS/REPLIES ON 2 GHz PCS PIONEERS PREFERENCE NPRM

Keep Pioneers Preference	In Favor of Retroactive Repeal	End PP No Retroactive Repeal
• 5 Investment Houses	• GTE, BellSouth, Nextel	• Southwestern Bell
• Small Business Admin.		• Henry Geller
• 3 RBOCs		
• 3 Independent Cellular Co.		
• 5 Manufacturers		
• 6 "Independents"		
• 3 Tentative PPs		
• "Appellants"		
35 In Favor of Pioneers Preference	**3 For Retroactive Repeal**	**2 for No Pioneers Preference, No Retroactive Repeal**

84% Favored Keep Pioneers Program and NO Retroactivity

JULY 5, 1994

HAND DELIVER
WILLIAM F. CATON
ACTING SECRETARY
FEDERAL COMMUNICATIONS COMMISSION
1919 M STREET, N.W., ROOM 202
WASHINGTON, D.C. 20554

RE: EX PARTE PRESENTATION
ET DOCKET 93-266

DEAR MR. CATON

ROYALTIES ARE THE FAIREST AND MOST LOGICAL WAY TO DEAL WITH PAYMENTS BY PIONEERS

In light of recent concerns, the purpose of this letter is to suggest ways that the Commission can continue the pioneers preference program in a manner which obtains fees for the government while offering a true incentive to entrepreneurs to invest in innovation. The letter deals with both the prospective as well as retroactive questions raised by the NPRM last October in Docket 93-266, and as such is a non-restricted proceeding.

Outlined below is a specific royalty proposal set against a minimum. It is also critical that a small business pioneer should have the option to have the minimum established relative to the price actually paid by other small businesses.

The pioneers preference program must also be analyzed in light of the specific auction rules recently adopted. For example, given the defacto 60% discounts proposed for designated entities, charging a pioneer 90% of such a *bid* price would result in an innovator paying *50% more* than the cost to others. Indeed, it could well result in paying 50% more than the true value put on the license by others. Worse, it could also result in a pioneer paying *multiples* of what others actually pay if firms default on payments in later years.

The FCC has shown tremendous creativity in solving the problems facing PCS and the implementation of auctions. The proposed rules in those dockets demonstrate an extraordinary willingness to break out of traditional assumptions about what can and cannot be done. The detailed rules covering designated entities clearly reflect this Commission's ability to understand the details of the problems facing entrepreneurs in a world of auctions. Similar detailed issues concern the pioneers preference program. Similar creative thinking is necessary to solve these issues.

We believe the proposal outlined below offers a true solution to these and the other concerns with "discount" only methods for charging pioneers discussed before.

SIMPLE "DISCOUNT" MECHANISMS DO NOT WORK IN THE CONTEXT OF A PIONEERS PROGRAM

In the letter we sent to Commissioner Ness on June 22, 1994 and copied to the other Commissioners we outlined the problems with using "discounts" for a program intended to incentivize entrepreneurs to invest in highly risky innovations ***before*** a spectrum allocation is made, ***before*** a license is awarded, and ***before*** the results of an auction are known. As noted, there are many problems with "discounts" in a pioneers preference program. A bidding discount defeats the purpose of the program because it in no way assures a license to the pioneer to try the innovation. But the alternative "discount" idea, i.e. assessing a charge on the pioneer's license as a discount to the winning bid on another license is also flawed as an incentive for innovation. The underlying problem with this sort of a "discount" method is that it bases the payments of the pioneer not on what the pioneers business could justify, but instead on what some other business is willing to ***bid*** for a license ***regardless of how speculative the bid price turns out to be*** and regardless of how they will use the license or what unique assets they can exploit.

How does a small, entrepreneurial company raise money to ***develop*** an innovation if it has to tell potential investors that it has no idea how much it will have to pay for a license to use the innovation or what the value of the "discount" is? The value of the discount on another license will be set by other parties and may not be exploitable by the pioneer. **If the only parties to whom a license is worth, for example, 80-90% of the winning bid for another license are the losing bidders, then the pioneer may end up with nothing; neither the license nor the value of the discount. A discount of unknown dollar value is largely meaningless if the pioneer is simultaneously *unable to justify the price* yet is restricted from selling the license for three years.**

No other industry has this problem of the entrepreneur having no ability to estimate the cost of the shelf space for bringing its product to market. In any other high tech industry start up, the business plan consists of expense estimates which are largely under the control of the entrepreneur. No other business has the risk of funding the development of innovation while having the cost of the shelf space set in an auction by others, which it may never be able to outbid, nor justify the speculative bid amount.

INCENTING RISK CAPITAL FOR INNOVATION IS A SEPARATE PUBLIC POLICY GOAL AND CAN JUSTIFY USING PAYMENT TECHNIQUES TAILORED TO ACHIEVE THAT GOAL

Royalties on gross revenues (or possibly per subscriber user fees based on per subscriber revenues), can be implemented in ways which overcome all of the problems with "discounts". Royalties tie the payments to the success of the pioneers business and not to the speculative bids of other parties. A royalty of 3%-5% on gross revenue over 10 years is equivalent to 50% or more of the profits of any normal competitive business. Royalty payments can also have a minimum cumulative total amount due over 10 years. In the event there is a royalty shortfall relative to this minimum, the remaining amount can be made up for in the tenth year. The minimum can be set as 80% of the national per "pop" average actually paid by the bidders. This evens out the problem of trying to find

"comparables" that don't exist (especially ***prior*** to a spectrum allocation or auction, which is when the pioneers must apply), while still providing an incentive to the entrepreneur.

Royalties Do Not Have Implementation Problems When Applied to Pioneers Licenses

* The Pioneers license is dispositive, thus there is no problem of comparing royalty bids as there would be in an auction

* The number of Pioneers will always be very small, thus auditing is easily manageable

* The royalty can be set on revenue in a way which prevents gaming, or can be set as a per subscriber user fee based on per subscriber revenue

* A minimum cumulative dollar amount for the ten year period can be set relative to a percentage of the national average price paid per "pop"

* A royalty method could be optional for the pioneer, with graduated installment payments resembling expected royalties (based on the minimum defined above) in the form of a step function as an alternative. Thus pioneers that had reasons why a royalty couldn't work could always elect the alternative graduated installment method or even prepay the graduated amounts at any time.

A royalty of 3%-5% of revenue is equivalent to 50% or more of expected profits in any competitive industry. For example, with the advent of six new PCS licenses in addition to two ESMR licenses and the two incumbent cellular operators, profitability in a wireless industry with 7-10 competitors will clearly be driven to normal competitive margins. By having a pioneer pay the equivalent of half its hoped for profits to the government, the pioneer is compensating the public in effect as a partner in return for the government providing the pioneer with the right to the shelf space to bring its innovations to the consumer. The remaining profits are necessary to pay a return on the enormous capital required to build and operate wireless services.

SMALL BUSINESS PIONEER'S PAYMENT MECHANISMS SHOULD BE EVALUATED RELATIVE TO WHAT OTHER SMALL BUSINESSES ACTUALLY PAY

It is critical to the small business pioneer to have the option of any minimum cumulative total amount established by what is actually paid by other small businesses.

As Sarah Sideman of the Commission's staff stated in the June 29, 1994 FCC Open Meeting:

> **"We do not believe that bidding credits would be especially meaningful [to small businesses] in an uninsulated block, especially in the 30MHz MTAs. Indeed, a number of commenters have stated that extraordinarily large credits even on the order of 50% or more would be ineffective in this particular service."**

The New York Times in their June 30, 1994 article stated that, "FCC officials estimated that the combined package of preferences added up to an effective discount of more than 60%."

The creation of an Entrepreneurs Band in PCS is the first step in recognizing that small businesses cannot possibly match bids with large businesses. This will be equally true in other dockets in the future. For the same reasons stated above, the small business pioneer should be compared to the per "pop" amounts paid by other small businesses, not to the bids of the giant companies. This is true even if the small business pioneer's license is not within an Entrepreneurs Band. The two purposes should not be put into conflict with one another.

Further, because there is no guarantee that the designated entity rules might not be gamed by some large entities, especially through non-ownership based contractual relationships, 80% of national average should be used to set the pioneer's minimum.

Perhaps most importantly, because some parties may overbid and then default, it is important to set the floor relative to what is *actually paid* by others over the ten year period. It is critical that the minimum be set by what is actually paid, or else the pioneers would be exposed to artificially inflated bids which turned out to be non-existent payments.

Note that this same problem applies to large business pioneers in a different form -- namely, that a bidder may later discover that it overpaid and thus never initiates service, or goes bankrupt. Despite the initial euphoria and free licenses, 5 of the 7 PCS operators in the UK went bankrupt. By having all pioneers pay with a royalty mechanism over 10 years, the total amounts actually paid by other surviving competitors will be known.

With respect to discussions of retroactive application of payment mechanisms to existing pioneers, the problems with simple discount mechanisms are brought into even greater relief. A 10%-20% discount relative to what others bid for another license not only has all the problems noted above and in our prior submissions, but it results in acting as a fine on the pioneers. There is absolutely no way of correlating the value of a *prospective* 10%-20% "discount" on the amount bid on another license with what a pioneer has ***already spent*** under a program when there was no intention of charging pioneers. The auctions haven't even been held yet. Any estimate of the theoretical value of a "discount" is purely speculative, especially considering the licenses cannot be transfered for three years.

Without commenting on the merits of Omnipoint's final award of a pioneer's preference, we can state that nearly $30 million has now been invested in the innovations which resulted in the award. Nearly $45 million is targeted to be spent by the estimated time of the auctions. How can any party know that a 10%-20% "discount" relative to another's bid will provide breakeven let alone a return on this investment?

All pioneers must make their investments when it is riskiest. The expected rate of return on venture capital is enormous relative to the discount rates used to evaluate operating businesses. Dr. Robert Pepper stated during the Question and Answer period after the June 29, 1994 FCC Open Meeting that **equity capital for small businesses bidding in an auction (where they don't have to spend the money unless they win) would normally command *20%-40% expected rates of return*. But existing pioneers already had to offer these rates of return because the investments had to be made made *before* knowing the outcome of any decision to award a license, any auction, indeed even *before* any spectrum allocation was made.**

We have heard no one propose that the pioneers be reimbursed if the "discount" falls short. How can anyone know that a 10%-20% "discount" to the *bid* on another license is the right balance?

Hopefully, the rationale for a royalty scheme as outlined above is clear. It ties the payments to the actual business of the pioneer. We urge the Commission to adopt this to preserve the original intent of the pioneers program.

Sincerely,

Douglas G. Smith
President, Omnipoint Corporation

cc: Honorable Reed Hundt
Honorable James Quello
Honorable Andrew Barrett
Honorable Rachelle Chong
Honorable Susan Ness
Mr. Don Gips
Mr. William Kennard

MONTGOMERY
SECURITIES

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June 29, 1994

Mr. James H. Quello
Commissioner
Federal Communications Commission
1919 M Street N.W.
Room 802
Washington D.C. 20554

Dear Commissioner Quello:

Congratulations on today's announcement specifying the rules for designated entities in broadband PCS. As the nation's leading underwriter of equity offerings for emerging growth companies in 1993, we applaud your efforts to increase competition in wireless services and look forward to participating in the financing of the new contenders for a piece of the wireless services pie.

Beyond extending our congratulations, we are writing to express our concerns as we prepare to commit our share of the huge capital resources needed to make the PCS vision real for new competitors. As I'm sure you're well aware, designated entities will require substantial capital commitments prior to bidding on licenses and, if successful, building out their networks. Along these lines, we have already received numerous inquires from firms planning to participate as designated entities in PCS. While certainly speculative, we nonetheless believe that many of these firms would present attractive investment opportunities within the financial community.

However, at present we have a fundamental issue pertaining to the FCC that at this point gives us pause in moving forward on capital commitments. Specifically, it is difficult for us to have confidence in the current designated entity policy given that the FCC has not granted the Pioneer's Preference licenses and appears from various press articles to be considering retroactively charging for these licenses. The example of the presumed Pioneer's Preference winners provides the best illustration of our concern due to the similarity of some of their circumstances to those of the designated entities (i.e. both groups are smaller companies with special characteristics--either technology or disadvantaged status--requiring FCC preferences to compete against larger, well capitalized companies).

We have followed the FCC's PCS initiative since its inception, and considered the broadband Pioneers' story complete at the time of the FCC's final ruling in December 1993. Although we have no affiliations with the Pioneers, the prospect of a retroactive change in this program raises deep concerns as we consider moving forward with the possible financing of designated entities. The issue is, essentially, how can we commit capital to new entrants if the Pioneer's Preference program ends up showing

that the basic rules of the game may be retroactively altered after investment decisions have already been made?

Based on the need for a reasonable level of certainty in the capital markets, we strongly recommend that you uphold the current Pioneer's Preference decisions and maintain consistent support of rule making for designated entities an other potential broadband PCS participants.

We would very much like to speak with you directly should you desire more input from the financial community. Please feel free to give me a call at (415) 627-2758.

Sincerely,

SECURITIES

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Michael B. Gordon
Vice President
Montgomery Securities